

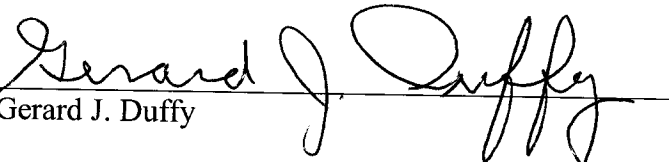
Courts have increasingly found that preemption by the FCC of traditional state authority over intrastate matters requires a clear statement of such preemption power in the authorizing federal legislation. *State of Tennessee and State of North Carolina v. FCC*, 832 F.3d 597 (6th Cir. 2016); *Nixon v. Missouri Municipal League*, 541 U.S. 125 (2004); *Abilene v. FCC*, 164 F.3d 49 (D.C. Cir. 1999). Here, there is no clear FCC authority to preempt Alaska's basic certification authority and associated regulatory treatment of local exchange carriers and intrastate interexchange carriers. In fact, the Commission's FCC Part 32 regulations cited by Moss Adams (Sections 32.1500, 32.4370 and 32.7910) refer only to the "cumulative impact" on assets, liabilities, deferred credits, revenues and expenses "of jurisdictional ratemaking practices which vary from those of the [FCC]." They actually recognize the possibility of differences between federal and state accounting practices, and offer no indication that Moss Adams, USAC or other auditors may rely upon them as a basis for finding any conflict with -- much less, effectively preempting or otherwise ignoring or disregarding -- Alaska's statutes and regulations regarding the certification and operations of its local exchange and intrastate interexchange carriers.

CONCLUSION

CVTC's lease to its interexchange affiliate of interexchange dark fiber that it was prohibited by Alaska law and its Alaska CPCN from using in its local exchange operations, and its purchase of some of the tariffed interexchange services offered by CVLD to the public over the subsequently lit and otherwise transformed fibers was not in form, intent, or operation a "sale-and-lease-back" arrangement of the type subject to Section 36.2(c)(2) of the Rules. Rather, the CVTC-CVLD arrangement was a good faith effort by CVTC to comply with Alaska state law and Alaska Commission enforcement policies which prohibited CVTC from providing interexchange services.

The Commission, which has a long and consistent record of cooperation with state commissions and state law, has never previously penalized a high-cost support recipient like CVTC by disallowing or reducing its support due to actions that it was required to take in order to comply with state law. Therefore, the Commission is respectfully requested to review and reverse the Administrator's Decision on High Cost Program Appeal, dated March 27, 2019, and to order that no recovery of High Cost Program support for CVTC's Study Area Code 613006 should or will be made (rather than the proposed amount of \$1,547,112).

Respectfully submitted,
COPPER VALLEY TELEPHONE COOPERATIVE, INC.

By: 
Gerard J. Duffy

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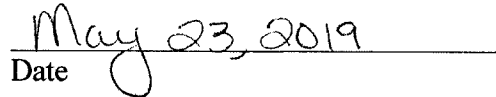
Dated: May 24, 2019

DECLARATION UNDER PENALTY OF PERJURY

I, Laura Kompkoff, hereby declare, under penalty of perjury, that:

1. I am the Chief Financial Officer of Copper Valley Telephone Cooperative, Inc. ("CVTC").
2. I have reviewed and am familiar with the "Request For Review" of a Universal Service Administrative Company Decision, dated March 27, 2019, that CVTC is filing with the Federal Communications Commission on May 24, 2019. The factual representations made in that "Request for Review" are true and correct to the best of my knowledge, information and belief.


Laura Kompkoff


Date

CERTIFICATE OF SERVICE

I, Gerard J. Duffy, hereby certify that an exact copy of the foregoing REQUEST FOR REVIEW was hand-delivered to the following address on Friday, May 24, 2019:

Universal Service Administrative Company
700 12th Street NW (#900)
Washington, DC 20005

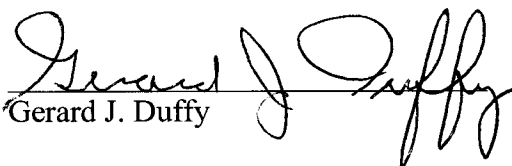

Gerard J. Duffy

EXHIBIT NO. 1

Administrator's Decision on High Cost Program Appeal

Performance Audit on Compliance with the Federal Universal
Service Fund High Cost Support Mechanism Rules

Copper Valley Telephone Company
USAC Audit ID: HC2016BE030
SAC No.: 613006

Disbursements Made During the
Year Ended December 31, 2015

MOSS-ADAMS_{LLP}

Certified Public Accountants | Business Consultants

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MOSS-ADAMS LLP
 Certified Public Accountants | Business Consultants

EXECUTIVE SUMMARY

September 5, 2018

Universal Service Administrative Company
 700 12th Street N.W., Suite 900
 Washington, DC 20005

Attention: Ms. Telesha Delmar

This report represents the results of Moss Adams LLP's (we, us, our, and Moss Adams) work conducted to address the performance audit objectives relative to Copper Valley Telephone Company, Study Area Code (SAC) No. 613006, (Copper Valley or Beneficiary) for disbursements of \$11,116,061 made from the Universal Service High Cost Program (HCP) (Disbursements) during the year ended December 31, 2015. At your request, we have also calculated the estimated monetary impacts of the issues identified in Finding #1 and Finding #2 on HCP disbursements during the years ended December 31, 2012, 2013, 2014, and 2016 based on information provided by the Beneficiary related to those findings.

We conducted our performance audit in accordance with the standards applicable to performance audits contained in generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States (2011 Revision). Those standards require that we plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The audit included examining, on a test basis, evidence supporting the data used to calculate support, as well as performing other procedures we considered necessary to form conclusions. We believe the evidence we have obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. However, our performance audit does not provide a legal determination of the Beneficiary's compliance with specified requirements.

The objective of this performance audit was to evaluate the Beneficiary's compliance with the regulations and orders governing the federal Universal Service High Cost Support Mechanism, set forth in of 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support for the HCP relative to the disbursements (collectively, the Rules).

Ms. Telesha Delmar
Universal Service Administrative Company
September 5, 2018

Based on the test work performed, our audit disclosed two detailed audit findings (Finding or Findings) discussed in the Audit Results section. For the purpose of this report, a Finding is a condition that shows evidence of non-compliance with the Rules that were in effect during the audit period.

Certain information may have been omitted from this report concerning communications with Universal Service Administrative Company (USAC) management or other officials and/or details about internal operating processes or investigations.

This report is intended solely for the use of USAC, the Beneficiary, and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of those procedures for their purposes. This report is not confidential and may be released to a requesting third party.

Moss Adams LLP

Overland Park, Kansas
September 5, 2018

Audit Results	Monetary Effect	Recommended Recovery
Finding #1: 47 C.F.R. § 64.901(a) and (b) - Incorrect nonregulated adjustments for rate base and expenses: The Beneficiary did not make proper nonregulated adjustments to remove cable and wire assets and the associated accumulated depreciation and depreciation expense from the regulated balance in its 2013 HCP filings. Additional work performed also indicates the Beneficiary did not make the proper nonregulated adjustments in its 2010, 2011, 2012, and 2014 HCP filings.	\$(697,826)	\$(697,826)
Finding #2: 47 C.F.R. § 36.2(c)(2) - Incorrect treatment of substantial rent expense paid to an affiliate: The Beneficiary incorrectly included \$895,047 of rent expense paid to an affiliate in its 2013 HCP filings instead of properly removing the rent expense and including the rented plant and related expenses. Additional work performed also indicates the Beneficiary incorrectly included the affiliate rent expense and did not include the rented plant and related expenses in its HCP filings for the years 2010, 2011, 2012, and 2014. The 2010 HCP filings included \$716,776 of affiliate rent expense. The 2011 HCP filings included \$860,792 of affiliate rent expense. The 2012 HCP filings included \$858,360 of affiliate rent expense. The 2014 HCP filings included \$451,533 of affiliate rent expense.	\$2,244,938	\$2,244,938
Total Net Monetary Effect	\$1,547,112	\$1,547,112

USAC management concurs with the audit results and will seek recovery of the High Cost Program support amount noted in the chart below. USAC requests that the Beneficiary provide a detailed description of the policies and procedures implemented to address the findings no later than sixty (60) days after receipt of this audit report. Please submit the requested information to hcaudits@usac.org. The Beneficiary may be subject to further review if the Beneficiary does not provide the requested information to USAC.

	ICLS	LSS	HCLS	USAC Recovery Action
Finding #1	(\$152,607)	(\$13,331)	(\$531,888)	(\$697,826)
Finding #2	\$516,831	\$223,735	\$1,504,372	\$2,244,938
Mechanism Total	\$364,224	\$210,404	\$972,484	\$1,547,112

As a result of the audit, USAC management will recover \$1,547,112 of High cost Program support from the Beneficiary for SAC 613006.

BACKGROUND

The Beneficiary is a cost-based eligible telecommunications carrier (ETC) that provides telecommunications exchange services, including local access, long distance, and Internet services to residential and business customers residing in areas of south central Alaska.

PROGRAM OVERVIEW

USAC is an independent not-for-profit corporation that operates under the direction of the Federal Communications Commission (FCC) pursuant to 47 C.F.R. Part 54. The purpose of USAC is to administer the federal Universal Service Fund (USF), which is designed to ensure that all people, regardless of location or income have affordable access to telecommunications and information services. USAC is the neutral administrator of the USF and may not make policy, interpret regulations, or advocate regarding any matter of universal service policy.

The High Cost Program (HCP), a component of the USF, ensures that consumers in all less populated areas of the country have access to and pay rates for telecommunications services that are reasonably comparable to those services provided and rates paid in urban areas. The HCP consists of the following support mechanisms:

- High cost loop support (HCLS): HCLS is available for rural companies operating in service areas where the cost to provide service exceeds 115% of the national average cost per loop. HCLS includes the following:
 - Safety net additive (SNA): SNA support is available for carriers that make significant investment in rural infrastructure in years when HCLS is capped and is intended to provide carriers with additional incentives to invest in their networks.
 - Safety valve support (SVS): SVS is available to rural carriers that acquire high cost exchanges and make substantial post-acquisition investments to enhance network infrastructure.
- High cost model (HCM): HCM support is available to carriers serving wire centers in certain states where the forward looking costs to provide service exceed the national benchmark.
- Local switching support (LSS): LSS was available to rural incumbent local exchange carriers (ILEC) serving 50,000 or fewer lines and is designed to help recover the high fixed switching costs of providing service to fewer customers. LSS was phased out June 30, 2012, and was replaced by the Connect America Fund (CAF) as of July 1, 2012.
- Connect America Fund Inter-carrier Compensation support (CAF ICC): CAF ICC support was established in the *2011 Transformation Order* as part of the transitional recovery mechanism adopted to mitigate the effect of reduced inter-carrier compensation revenues. CAF ICC is the universal service support available to cover the difference between the amount of recovery a carrier is eligible to receive and the amount it may recover through permitted end user charges. For rate-of-return incumbent LECs, the baseline recovery was established at a fixed amount in 2012 and is reduced by five percent annually.

CAF ICC disbursements began July 1, 2012.

- Interstate common line support (ICLS): ICLS is available to ILECs and is designed to help its recipients recover common line revenue requirement while ensuring the subscriber line charge (SLC) remains affordable to customers. The common line revenue requirement is related to facilities that connect end users to the carrier's switching equipment.
- Interstate access support (IAS): IAS is available to price-cap ILECs and competitive carriers, and is designed to offset interstate access charges.

OBJECTIVE

The objective of our performance audit was to evaluate the Beneficiary's compliance with 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's Orders governing Federal Universal Service Support for the HCP relative to the disbursements for the 12-month period ended December 31, 2015.

This performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards*. We were not engaged to, and do not render an opinion on the Beneficiary's internal control over financial reporting or internal control over compliance. We caution that projecting the results of our evaluation on future periods is subject to the risks that controls may become inadequate because of changes in conditions that affect compliance.

SCOPE

The following chart summarizes the Universal Service High Cost Program support that was included in the scope of this audit:

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2014- 6/30/2015 & 7/1/2015- 6/30/2016	12/31/2015	\$462,366
High Cost Loop Support (HCLS)	12/31/2013	12/31/2015	\$7,503,269
Interstate Common Line Support (ICLS)	12/31/2013	12/31/2015	\$3,150,426
Total			\$11,116,061

ADDITIONAL WORK

At USAC's request, we determined that the affiliate circuit rent expense and incorrect nonregulated adjustments that resulted in findings 1 and 2 were also present in the high cost forms filed for the three years prior to and the one year after the 2013 data period year. We did not perform any other procedures outlined in the audit methodology section for those other periods. The following charts summarize the Universal Service High Cost Program support relating to the incorrect treatment of substantial rent expense paid to an affiliate and incorrect nonregulated adjustments for the disbursement period years ended December 2012, 2013, 2014 and 2016.

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2012- 6/30/2013	12/31/2012	\$418,680
High Cost Loop Support (HCLS)	12/31/2010	12/31/2012	\$7,704,933
Interstate Common Line Support (ICLS)	12/31/2010	12/31/2012	\$3,423,258
Local Switching Support (LSS)	12/31/2010	12/31/2012	\$597,312
Safety Net Additive Support (SNA)	12/31/2010	12/31/2012	\$86,976
Total			\$12,231,159

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2012- 6/30/2013 & 7/1/2013- 6/30/2014	12/31/2013	\$233,814
High Cost Loop Support (HCLS)	12/31/2011	12/31/2013	\$8,003,454
Interstate Common Line Support (ICLS)	12/31/2011	12/31/2013	\$3,368,208
Local Switching Support (LSS)	12/31/2011	12/31/2013	(\$227,916)
Total			\$11,377,560

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2013- 6/30/2014 & 7/1/2014- 6/30/2015	12/31/2014	\$385,956
High Cost Loop Support (HCLS)	12/31/2012	12/31/2014	\$7,941,204
Interstate Common Line Support (ICLS)	12/31/2012	12/31/2014	\$3,087,846
Local Switching Support (LSS)	12/31/2012	12/31/2014	\$0
Total			\$11,415,006

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2015- 6/30/2016 & 7/1/2016- 6/30/2017	12/31/2016	\$569,976
High Cost Loop Support (HCLS)	12/31/2014	12/31/2016	\$5,896,762
Interstate Common Line Support (ICLS)	12/31/2014	12/31/2016	\$3,014,721
Local Switching Support (LSS)	12/31/2014	12/31/2016	\$0
Total			\$9,481,459

AUDIT METHODOLOGY

To accomplish our audit objective, we performed the following procedures:

Reconciliation – We reconciled the December 31, 2013 and 2012, trial balances to the separations and Part 64 study inputs and then to the applicable HCP Forms, obtained explanations for any variances, and evaluated the explanations for reasonableness.

Rate Base and Investment in Network Facilities – We utilized an attribute sampling methodology to select asset samples from central office equipment (COE) and cable and wire facilities (CWF) accounts. Asset selections were made from continuing property record (CPR) detail. We determined that balances for the selected assets were properly supported by underlying documentation such as work order detail, third-party vendor invoices, materials used sheets, and time and payroll documentation for labor and related costs. We agreed the amounts charged to work order detail and verified the proper general ledger coding under Part 32. In addition, we verified the physical existence of selected assets.

Tax Filing Status – We verified the tax filing status for the Beneficiary and obtained and reviewed the tax provision and deferred income tax provision calculations, including supporting documentation, for reasonableness.

Postretirement Benefit Liability Accounting – The Beneficiary does not have any postretirement benefit plans; therefore, no testing was performed.

Expenses – We utilized an attribute sampling methodology to select expense samples from operating expense accounts that impact HCLS, ICLS, and CAF ICC. Payroll selections were made from a listing of employees. We agreed the amounts to supporting documentation such as time sheets, labor distribution reports, and approved pay rates, and verified the costs were coded to the proper Part 32 account. We reviewed benefits and clearings for compliance with Part 32.

We made other disbursement selections from accounts payable transactions and agreed amounts to supporting documentation, reviewing for proper coding under Part 32. We selected a sample of manual journal entries to ensure reclassifications between expense accounts were appropriate and reasonable.

Affiliate Transactions – We performed procedures to assess the reasonableness of affiliate transactions that occurred during the period under audit. These transactions involved the provision of services between the Beneficiary and other entities with common ownership. We noted the Beneficiary holds equity ownership in four entities. These affiliates include Copper Valley Holdings, Inc. (100% ownership, "CV Holdings"), Copper Valley Wireless, LLC (100% ownership, "CV Wireless"), Copper Valley Long Distance, Inc. (100% ownership, "CVLD"), and Copper Valley Solutions, LLC (100% ownership, "CV Solutions"). We selected a sample of various types of transactions to determine if the transactions were recorded in accordance with 47 C.F.R. Section 32.27 and categorized in the appropriate Part 32 accounts.

The following transactions were selected for testing:

- Land and building rents – The Beneficiary rents office space from CV Wireless. Transactions occur at fully distributed cost.
- General support asset rents – The Beneficiary rents general support assets, including tools, work equipment, computers, furniture and other equipment from CV Wireless and CV Solutions. Transactions occur at fully distributed cost.
- Special access services – The Beneficiary pays for the use cable and wire plant assets controlled by CVLD to transport DSL traffic and to monitor its central offices. Transactions occur at CVLD's tariffed rates.
- Dark fiber leases – The Beneficiary leases dark fibers to CVLD. Transactions occur at fully distributed cost.

Revenues and Subscriber Listings - We tested revenue general ledger accounts, subscriber bills, and other documentation to verify the accuracy and existence of revenues. We utilized an attribute sampling methodology to select revenue samples from subscriber listings. Our testing of subscriber bills consisted of procedures to ensure the lines were properly classified as residential, single-line business, or multi-line business. In addition, we reconciled the revenues reported to National Exchange Carrier Association (NECA) to the general ledger and billing support. We obtained subscriber listings and billing records to determine the lines or loops reported in the HCP filings agreed to supporting documentation. Our analysis included reviewing the listing for duplicate lines, invalid data, and nonrevenue producing lines.

Part 64 Allocations – We reviewed the Beneficiary's cost apportionment methodology and assessed the reasonableness of the allocation methods and corresponding data inputs used to calculate the factors, recalculated the material factors, and recalculated the material amounts allocated. We also evaluated the reasonableness of the assignment between regulated, nonregulated, and common costs and the apportionment factors as compared to the regulated and nonregulated activities performed by the Beneficiary.

COE and CWF Categorization – We reviewed the methodology for categorizing assets including a comparison to network diagrams. We reconciled the COE and CWF amounts to the cost studies and agreed them to the applicable HCP Forms. In addition, we reviewed power and common allocation and physically inspected a sample of COE assets and tested route distances of CWF for reasonableness.

Revenue Requirement – We recalculated the Beneficiary's revenue requirement using our cost allocation software program and reviewed the calculation of revenue requirement including the applications of Part 64, 36, and 69 for reasonableness. In addition, we traced cost study adjustments that were not recorded in the general ledger to supporting documentation and reviewed them for reasonableness.

Our performance audit resulted in the following detailed audit findings and recommendations with respect to the Beneficiary's compliance with the Rules. We also included an estimate of the monetary impact of the findings relative to 47 C.F.R. Part 54, Subparts C, D, K, and M, Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B, as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support applicable to the disbursements made from the HCP during the year ended December 31, 2015.

FINDING No.: HC2016BE030-F01: 47 C.F.R. § 64.901 (a) and (b) - INCORRECT NONREGULATED ADJUSTMENTS FOR RATE BASE AND EXPENSES

Condition -

The Beneficiary made nonregulated adjustments for cable and wire assets by assigning the asset to a non-interstate category in its cost studies. However, the assets, accumulated depreciation, depreciation expense, and related maintenance expenses should have been removed from the cost studies and HCP filings.

Cause -

The processes to prepare, review, and approve the cost studies and HCP filings did not identify and remove the correct balances.

Effect -

The Beneficiary's approach to the nonregulated adjustments identified above, for the years 2012 - 2016 resulted in a lower allocation of rate base and expenses to the Part 36 interstate jurisdiction. This also resulted in a lower loop plant allocation in the HCLS filings. This resulted in an average annual increase in rate base of \$1,793,551, an increase in depreciation expense of \$629,836 and an increase in plant specific expenses of \$257,003, which impacted HCLS, ICLS, and LSS. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, and for the additional years for the 12-month periods ending December 31, 2012, 2013, 2014, and 2016 is estimated to be an underpayment of \$697,826 and is summarized by support mechanism by disbursement period as follows:

Support Type	Monetary Effect - 2012	Monetary Effect - 2013	Monetary Effect - 2014	Monetary Effect - 2015	Monetary Effect - 2016	Total Monetary Effect
HCLS	\$(19,160)	\$(80,088)	\$(153,200)	\$(158,546)	\$(120,894)	\$(531,888)
ICLS	\$(11,754)	\$(29,780)	\$(36,985)	\$(38,747)	\$(35,341)	\$(152,607)
LSS	\$(7,139)	\$(6,192)	\$0	\$0	\$0	\$(13,331)

Recommendation -

The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response -

Beneficiary Copper Valley Telephone Cooperative, Inc. (CVTC) believes the approach taken, starting in 2005, to directly assign the asset to a non-interstate category in the cost study was a reasonable one. However, upon further review, it appears that the approach may not have properly handled the removal of the assets, accumulated depreciation, depreciation expense and maintenance expenses in the related HCP filings. CVTC accepts this finding and will incorporate the changes recommended by the auditor going forward.

FINDING No.: HC2016BE030-F02: 47 C.F.R. § 36.2(c)(2) - INCORRECT TREATMENT OF SUBSTANTIAL RENT EXPENSE PAID TO AN AFFILIATE

Condition -

The Beneficiary incorrectly included expense amount in the following years in accounts 6123, 6124, 6212 and 6232 for rent expense paid to an affiliate for the use of substantial interexchange plant assets controlled by its affiliate. The Beneficiary should have removed the rent expense and needed to include the rented interexchange plant and related expenses in its HCP filings in accordance with FCC rules.

Year	Total Expenses
2010	
2011	\$716,776
2012	\$860,792
2013	\$858,360
2014	\$895,047
	\$451,533

Cause -

The processes to prepare, review, and approve the cost studies and HCP filings did not identify the affiliate transactions as substantial rents and the application of the requirements in 47 C.F.R. § 36.2(c)(2).

Effect -

The exception identified above, for the years 2010 - 2014, resulted in a reduction of plant specific expenses of \$3,782,508, an average annual increase in rate base of \$967,953 and an increase in depreciation expense of \$329,831, which impacted HCLS, ICLS, and LSS disbursements. Specifically, the adjustment reduced expenses that were previously reported as switching expense, circuit expense, and general support expense and replaced these expenses with imputed digital subscriber line (DSL) special access rate base and associated depreciation expense. The reduction of circuit expense and the inclusion of non-loop imputed rate base in the Beneficiary's HCLS and ICLS HCP filings caused HCLS and ICLS disbursements to decrease. In addition, the reduction of switching and general support expenses and inclusion of imputed non-interexchange rate base in the Beneficiary's LSS HCP filings caused LSS disbursements to decrease.



Universal Service
Administrative Co.

Administrator's Decision on High Cost Program Appeal

Via Email and Certified Mail

March 27, 2019

Gerard J. Duffy
Blooston, Mordkofsky, Dickens, Duffy & Prendergast, LLP
On Behalf of Copper Valley Telephone Cooperative, Inc.
2120 L Street NW, Suite 300
Washington, DC 20037

Re: Appeal of the High Cost Program Beneficiary: Copper Valley Telephone
Cooperative, Inc., HC2016BE030 SAC 613006

Dear Mr. Duffy:

The Universal Service Administrative Company (USAC) has completed its review of the Appeal filed by Copper Valley Telephone Cooperative, Inc. (Copper Valley). USAC engaged an outside firm (Moss Adams LLP) to conduct an Audit of Copper Valley's compliance with the Federal Communications Commission's (FCC) rules for the High Cost Program, which resulted in two findings.¹ Based on the Audit, on September 12, 2018, USAC issued a letter informing Copper Valley of the recovery amount of \$1,547,112.² On November 12, 2018, Copper Valley filed an appeal related to Finding 2.³ In the Appeal, Copper Valley requests that USAC reverse Finding 2.

USAC reviewed the Appeal and the supporting documentation. Based on its review of the Appeal and the supporting documentation, FCC rules, and the related facts in this matter, USAC has determined that Finding 2 of the Audit should not be reversed. Therefore, as discussed in detail below, USAC *denies* the Appeal.

BACKGROUND

The Audit. At USAC's request Moss Adams performed audit procedures to assess, among

¹ See Audit of Copper Valley Telephone Company, Compliance with High Cost Audit No. HC2016BE030 (SAC 613006), conducted by Moss Adams LLP (Performance Audit for the Universal Services High Cost Program Disbursements made during the years that ended December 2012, 2013, 2014, 2015, and 2016) (Sep. 5, 2018) (Audit Report).

² Audit Report at 3. Note: in the Audit Report, Moss Adams determined that the net monetary effect of Findings 1 and 2 totaled \$1,547,112. *Id.*; see Letter from USAC to Laura Kompkoff (Sept. 12, 2018) (stating that USAC would recover \$1,547,112 as result of the audit).

³ Letter from Gerard J. Duffy, Blooston, Mordkofsky, Dickens, Duffy & Prendergast, LLP, to USAC (Nov. 12, 2018) (Appeal).

other things, the reasonableness of affiliate transactions, including the provision of services between Copper Valley and Copper Valley Long Distance, Inc. (CVLD), a wholly-owned subsidiary of Copper Valley. Regarding Finding Two (Incorrect Treatment of Substantial Rent Expense Paid to an Affiliate), Moss Adams determined that transactions between Copper Valley and CVLD resulted in a sale and lease-back arrangement in which Copper Valley did not comply with the procedures for separating telecommunications expenses, because it did not identify certain affiliate transactions as substantial rents, as required under section 36.2(c)(2) of the FCC's rules.⁴

During the audit, Copper Valley stated that under Alaska law, it is expressly authorized to provide local exchange telecommunication service, while CVLD is authorized to provide intrastate interexchange telecommunications service.⁵ Copper Valley maintained that the expenses at issue in Finding Two are not substantial rental expenses arising from a sale and lease-back transaction, and are therefore not subject to section 36.2(c)(2).⁶ Copper Valley stated that the underlying transaction was a bona fide arrangement required under Alaska law.⁷

After consideration of evidence presented by Copper Valley, Moss Adams determined that section 36.2(c) of the FCC rules was applicable, and therefore determined that, in Disbursement Years 2012, 2013, 2014, 2015, and 2016, Copper Valley had received overpayments totaling \$2,244,938 related to Incorrect Treatment of Substantial Rent Paid to an Affiliate.⁸

The Appeal. In its Appeal, Copper Valley argues that the Copper Valley and CVLD "special contracts are not a regulatory manipulation subject to §36.2(c)(2) of the FCC

⁴ See Audit Report at 12, 19. Moss Adams determined that as result of the incorrect treatment of the rent expense, Copper Valley received/reported (1) a reduction of plant specific expenses of \$3,782,508; (2) an average annual increase in its rate base of \$967,953; and (3) an increase in its depreciation expense of \$329,831. *Id.* at 12. See also 47 C.F.R. § 36.2 (fundamental principles underlying jurisdictional separations procedures).

⁵ Appeal at 2-3. Alaska law requires separate Certificates of Public Convenience and Necessity (CPCNs) for different types of public utility services and "limits the nature and extent of such certifications to described authorized areas and scopes of operations." Appeal at 2, citing Alaska Statutes at AS 42.05.221(a).

⁶ Audit Report at 13. Copper Valley explained that it completed a buried fiber optic facility between its two largest local telephone exchanges with 24 strands of dark fiber. Appeal at 4. Copper Valley stated that because the CPCN did not allow it to provide intrastate interexchange local exchange service, it entered into a Special Contract with CVLD for a dark fiber lease of four fiber strands. *Id.* at 4-5. It indicated that the Alaska Commission "granted a waiver of the certification requirements, to the extent necessary, to allow [Copper Valley] to sell interexchange service for the sole purpose of the Special Contract." *Id.* at 5. It indicated that, after leasing the dark fiber strands, CVLD "improved them by adding the electronics necessary to light them and to provide interexchange services over them." *Id.* at 6. Copper Valley stated that it subsequently constructed two additional fiber optic routes and again leased four of 24 dark fiber strands to CVLD, who improved them by adding the necessary electronics to light them and provided interexchange services over them. Appeal at 7.

⁷ Audit Report at 13. Copper Valley maintained that it properly treated the tariffed charges for CVLD's interexchange services as expenses in compliance with the FCC's affiliate transaction rules. *Id.*

⁸ Audit Report at 13.

rules” because the contracts were required pursuant to Alaska law.⁹ Copper Valley also asserts that “it is inequitable and unlawful to punish [Copper Valley] for complying with Alaska Law;” and upholding the Auditor’s position places the FCC in the position of preempting Alaska’s regulations, contrary to section 221(b) of the Communication Act.¹⁰ Copper Valley therefore requests that USAC reverse the Audit finding.¹¹

Discussion

USAC denies the Appeal because FCC rules do not support a reversal of the finding and Copper Valley does not present any new facts or arguments not already addressed in the Audit.

The FCC developed rules to assign or allocate the costs to build and maintain the network and the revenues derived from the array of services offered over the network, by type of cost, type of service (regulated or nonregulated), jurisdiction (intrastate or interstate), and service categories. Under Part 32 of the FCC rules, carriers such as Copper Valley must record their investments, expenses, and other activities in the uniform system of accounts.¹² The rules differ if the investments and expenses are included in collection with affiliate transactions. Under FCC’s Part 36 jurisdictional separations rules, carriers must separate their regulated investments, expenses and revenues between the intrastate and interstate jurisdictions.¹³ Section 36.2(c) governs the treatment of rented property, related expenses and lease payments between carriers and their affiliates for separations.¹⁴ Under section 36.2(c)(2), the FCC requires an incumbent local exchange carrier, in the case of a substantial sale and lease-back of assets to and from its affiliate, to continue to categorize the assets as an investment, and exclude the lease expenses from its expense categories, in its cost study submitted for

⁹ *Id.* at 9-12 (arguing that section 36.2(c)(2) refers to sale and lease-back agreements that are applied for the purposes of intentional manipulation of separations to increase support, but it did not enter into the contracts for that reason).

¹⁰ *See* Appeal at 13-14.

¹¹ *Id.* at 15.

¹² 47 C.F.R. pt. 32.

¹³ 47 C.F.R. pt. 36.

¹⁴ 47 C.F.R. 36.2(c) states:

Property rented to affiliates, if not *substantial in amount*, is included as used property of the owning company with the associated revenues and expenses treated consistently: Also such property rented from affiliates is not included with the used property of the company making the separations; the rent paid is included in its expenses. If substantial in amount, the following treatment is applied:

(1) In the case of property rented to affiliates, the property and related expenses and rent revenues are excluded from the telephone operations of the owning company, and

(2) In the case of property rented from affiliates, the property and related expenses are included with, and the rent expenses are excluded from, the telephone operations of the company making the separation (*emphasis added*).

separations and high-cost support purposes.¹⁵ In the *Moultrie Order*, with respect to section 36.2(c)(2), the FCC stated,

[w]hen a *substantial amount of investment is involved*, the jurisdictional allocation of the lease payment and the combined separations results would be skewed (*i.e.*, the overall interstate allocations may be artificially higher or lower), if the assets were not included in the appropriate separations categories and jurisdictionally allocated based on the rules for the investment-type involved. This occurs because the Part 36 system is premised upon incumbent local exchange carriers owning the majority of their operational assets...the Part 36 process of jurisdictional cost allocation is predicated on the recognition that incumbent telephone companies will experience large amounts of capital investment cost.¹⁶

While Copper Valley did not label the transactions with its affiliate as a sales and leaseback arrangement, the agreements were, in fact, a sale and lease back arrangement. Specifically, Copper Valley leased property to an affiliate, and the affiliate sold back services to Copper Valley using the same leased property.¹⁷ Copper Valley may not have intended to manipulate its separations or high cost loop support results, but the arrangement with CVLD resulted in Copper Valley receiving High Cost Program support that it was not entitled to under program rules – more than \$2.2 million over a five-year period. Under FCC rules, Copper Valley may not recover High Cost Program support for the relevant transactions with its affiliate.

With respect to Copper Valley's arguments related to Alaska law, USAC does not dispute that: (1) Alaska law prohibits carriers from simultaneously providing interexchange and local exchange services, (2) Alaska permitted Copper Valley to lease its dark fiber to its affiliate, or (3) Alaska allowed Copper Valley to purchase interexchange services from its affiliate. However, carriers that receive federal High Cost support must comply with the FCC's Part 36 jurisdictional separations rules.

Conclusion

For the reasons discussed above, USAC denies the Appeal. If you wish to appeal this decision or request a waiver, follow the instructions pursuant to 47 C.F.R. Part 54,

¹⁵ *Moultrie Independent Telephone Company, Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order, 16 FCC Rcd 18242, 18245, para. 6 (2001) (*Moultrie Order*) (denying the carrier's request for waiver of Part 36, and with respect to a sale and lease-back transaction, directing the carrier to include the property and related expenses, and exclude the related rent expenses from the carrier's regulated telephone operations, as required by 47 C.F.R. § 36.2(c)(2)).

¹⁶ *Id.* at 18248, para. 11 (*emphasis added*).

¹⁷ Copper Valley states that, during the 2014 year under audit, CVLD derived "only \$455,341 (8.98%)" of its \$5,069,852 private line service revenues from Copper Valley; and in other there was a clear pattern of Copper Valley's purchase of telecommunications services from CVLD over the leased fiber strands becoming a smaller and smaller portion of CVLD's business. Specifically, it states that CVLD's private line revenue from Copper Valley was: (a) in 2010, "only \$724,514.05 (30.48%);" in 2011, "only \$862,514.88 (24.02%);" in 2012, "only \$858,360.08 (19.44%);" in 2013, "only \$894,188.21 (19.00%)." Appeal at 8.

Gerard J. Duffy
March, 27 2019
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Subpart I (47 C.F.R. §§ 54.719 to 725); further instructions for filing appeals or requesting waivers is available at:

<http://www.usac.org/about/about/program-integrity/appeals.aspx>

Sincerely,

//s// Universal Service Administrative Company

EXHIBIT NO. 2

Moss Adams Audit Report